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First National City Bank Monthly Letter

Business and Economic Conditions

1955

New York, April, 1955

General Business Conditions

THE business recovery has made further progress in March. After several months of vigorous advance, many people had expected the upswing to level out by this time, but industrial and trade reports have continued buoyant. Retail stores are clearly headed for a record Easter season. Further gains have been made in automobile and steel output, on top of the high levels reached earlier. Construction activity is unabated.

The tendency of improvement to become cumulative is seen in surveys of prospective demand, which show that business expenditures on plant and equipment are expanding, while consumers are planning to buy more durable goods and housing this year than last. The Department of Commerce and the Securities and Exchange Commission report that the decline in business outlays for capital goods appears to have hit bottom in the first quarter, approximately 10 per cent below the peak in the third quarter of 1953, and that an upturn has begun.

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For 1955 as a whole, purchases of new plant and equipment are scheduled at $27.1 billion, compared with $26.8 billion in 1954.

Business men on the average seem to expect a 5 per cent increase in sales this year. On the whole they look for better earnings, despite the effect of keen competition on margins. With faith in expanding markets, and with a high rate of innovation and technological progress, it will be no surprise if final figures on capital expenditures in 1955 are better than the forecasts. Furthermore, purchasing agents are taking a longer view on inventories and commitments. Delivery time on many items has lengthened out. Consequently, needs are now being covered 30 to 90 days ahead, whereas only a few months ago most buying was in the hand-to-mouth to 30 days range.

Consumers also are confident and optimistic, according to a survey conducted for the Federal Reserve Board. They feel better off financially. In particular, plans to buy or fix up homes are greater than in any recent year. Seasonally adjusted sales of all retail stores (including automobile dealers) were greater in January and February than ever before, except for last year's record Christmas season. Department stores report substantial year-to-year sales increases in March even after allowing for the earlier date of Easter. Retail automobile sales in the first three months exceeded any other first quarter on record.

G.N.P. Back to the Peak

It now seems likely that the nation's total output of goods and services during the first three months of 1955 has drawn even with the all-time record set in the second quarter of 1953. In other words, the gross national product is now in the neighborhood of $370 billion a year. Thus, all – or virtually all – of the ground lost in last year's recession has been regained. The improvement is in real terms, reflecting gains

in the volume of goods and services rather than price increases, for the price level is steady. This recovery has taken a much shorter time than most observers anticipated only six months ago. Significantly, the upswing is in private demand with a minimum of Government intervention and without the inflationary measures still being advocated in some quarters.

Further encouragement is found in indications that the recovery is broadening — a necessary development if expansion is to continue. During the past six months, the upswing in automobiles, steel, and construction has been the major force behind the recovery. In the next six months, support must come from other sources. The latest figures on industrial production show that in February virtually all major industries were expanding output or maintaining earlier gains. Minerals output set a new record and nondurable goods manufacturing rose to within 2 per cent of its May 1953 peak. Production of major household durable goods was nearly one-fourth greater than a year earlier.

Will Recovery Broaden Further?

The key question is whether the advance in other lines has acquired enough momentum to sustain the rise in business activity should steel, auto, or construction activity slacken. One need not be a pessimist to see a decline ahead in automobile and steel output. Even the most bullish estimates for the full year fall short of current production rates. Passenger car output totaled 790,200 in March, an all-time record. Schedules for the second quarter call for over 2 million cars, approximately the same as the first quarter. This indicates a daily and weekly production rate close to that achieved in March. In other words, auto production is pressing against the ceiling. At best, the industry will not add anything to over-all activity during the second quarter. At some point a few months ahead, whether because of labor troubles, inventory adjustments, or model changes, it is likely to be a temporary source of weakness. In early March, President Curtice of General Motors raised his estimate of 1955 domestic output and demand by nearly one-seventh to 6.6 million passenger cars, but this record level would still be 2 million or more short of current production rates.

By the week ended March 20, steel mills had pushed operations to 94.2 per cent of capacity. Annual output at that rate would total 118.5 million tons, well above the 111.6 million turned out in 1953, the best year in the industry's history, and even further above most estimates for 1955 as a whole.

During 1954, 18.7 per cent of all steel shipped went directly to the automobile industry. By January 1955, auto companies were taking 26.9 per cent of steel shipments. Any setback in auto production will obviously cut considerably into steel output. However, the resurgence of demand for steel from other buyers is impressive. Backlogs are rising, and will help moderate the effects of a cutback in automotive orders.

Divergent Opinions

Where opinions as to the second half-year diverge, the difference centers chiefly on the weight to be given to the prospective automobile decline. From one point of view, the longer the automobile and steel industries operate above sustainable levels the greater will be the letdown when it comes. The opposite view is that the recovery itself is generating cumulative strength as expanded purchasing power flows around the circle; and that increased business investment in plant, equipment, and inventories, plus residential construction and strong consumer demand, will carry the upswing further regardless of a summer slackening. Since it is easy to find in current reports indications to support either way of thinking, both optimists and pessimists can make persuasive arguments, and opinions tend to fall definitely on the bullish or bearish side.

Actually, the probabilities may fall between the two extremes. The expected decline in automobile and steel output moderates any tendency to over-estimate the outlook and to carry capital expenditures and inventory accumulation to speculative extremes. Conversely, the tendency toward cumulative improvement and expansion diminishes the effect of the expected summer drop in production, which is also foreseen and presumably discounted in some degree. From this point of view, automobile and steel curtailment may check demand in other lines before it becomes excessive and builds up to a climax such as occurred in the spring of 1953. It would apply brakes not to the extent of depressing business, but to restrain over-buying and maintain fairly stable over-all levels.

It should go without saying that this is the outcome to be hoped for. Total business inventories changed relatively little between October and the end of January, but the increase in new orders all along the line indicates that re-stocking is starting. As long as inventory replenishment stays in line with increased shipments and backlogs of unfilled orders, it is a normal and necessary development. But the danger of carry-

ing such movements too far is recognized and was illustrated in 1953.

Fortunately, most business men seem to be keeping a careful eye on developments. To some observers, the very speed of the recovery has seemed too good to be true. They express misgivings about the high rate of housing starts, the growing burden of consumer instalment and mortgage debt, declining farm income, and scattered indications of commodity price weakness. They wonder whether people are overextending themselves, and are watching such sensitive indicators as delinquencies, garnishments, and foreclosures. So far no convincing danger signals have appeared, but these misgivings are worth bearing in mind. The confident but cautious optimism that has served business so well in recent years is still needed.

Corporate Earnings in 1954

Our tabulation of annual reports for the year 1954, now available for 3,442 companies representing all major lines, shows a combined net income after taxes of approximately $14.4 billion against $13.9 billion for the same companies in 1953. The increase is 4 per cent, the same as shown by our preliminary tabulation of 2,392 companies given here a month ago. The continued high earnings in the aggregate last year reflect the moderation of the recession in over-all production and distribution of goods, aided materially by the vigorous rebound of business in the final quarter. Another important factor was expiration of the federal excess profits tax at the end of '53.

Despite the relative stability shown by the totals of corporate net income for the full year, widely-mixed changes occurred among industry groups and individual companies. Although most of the main divisions of business, except transportation, made increases, the number of companies having decreases nevertheless made up 44 per cent of the total.

Net Income of Leading Corporations for the Years 1953 and 1954

(In Millions of Dollars)

No. of Cos.	Industry Divisions	Net Income After Taxes 1953	Net Income After Taxes 1954	Per Cent Change	% Margin on Sales 1953	% Margin on Sales 1954
1,778	Manufacturing	$ 8,924	$ 9,280	+ 4	5.3	5.9
68	Mining	137	138	+ 1	6.3	7.2
186	Trade (ret. & whol.)	569	597	+ 5	2.4	2.5
226	Transportation	1,026	796	—22	7.6	6.7
317	Public utilities	1,764	1,963	+11	12.5	12.6
116	Amusements, services	151	179	+19	4.3	4.7
751	Banks and finance	1,822	1,462	+11	—	—
3,442	Total	$13,898	$14,415	+ 4	5.6	6.1

The net profit margin in 1954 of all companies reporting sales or revenues, excluding the finance groups, averaged 6.1 per cent after taxes. This is moderately wider than the 5.6 per cent average in both 1953 and 1952. For most companies which had decreases in their dollar sales and pre-tax earnings, the squeeze in the latter was substantially and in some cases fully offset by the lower federal income taxes payable.

Net assets or net worth of the companies in our tabulation aggregated $140 billion at the beginning of last year, an increase of $9 billion over the preceding year. Upon this shareholders' equity, the net income gave an average return of 10.3 per cent in 1954, slightly short of the return of 10.6 realized in 1953 and 10.4 in 1952. The net assets included in this tabulation of published reports, representative for the most part of the country's larger organizations whose ownership is widely distributed among investors, amount to about half the total for all active U.S. corporations numbering 672,000.

The substantial addition to shareholders' equity reflects the continued heavy investment made by American corporate business every year since the war – and still running at a high level in 1955 – for the expansion and modernization of plant and equipment, plus building up working capital.

A summary by 70 major industry groups given on the next page shows the changes in net income, together with average rates of return on net assets and net profit margins on sales. Because of the extreme variation in rates of capital turnover among different industries, high profit margins do not necessarily mean high returns on the shareholders' investment, nor vice versa. A high margin on a limited volume of sales may still yield an under-average return, whereas a low margin on a large volume may yield an above-average return.

Manufacturers' Sales and Earnings

In the manufacturing industries, which in number of companies and capital investment comprise over half of the totals for all lines of business included in our tabulation, the 1,778 reporting companies show combined net income up 4 per cent. Tax details given by the larger companies indicate that in 1954, on an over-all volume of sales about 5 per cent lower than in 1953, pre-tax earnings were down 10 per cent. Liability for federal income and excess profits taxes declined by 25 per cent, with the portion of pre-tax earnings absorbed by such taxes in the two years declining from an average of 53 to 45 per cent.

On book net assets aggregating some $75 billion the net income represented an average re-

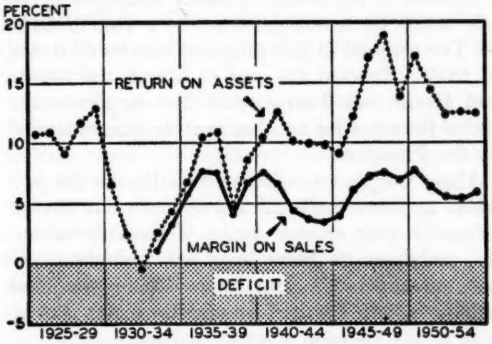
NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1953 AND 1954

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1953	Reported Net Income After Taxes 1954	Per Cent Change†	Book Net Assets Jan. 1-a 1953	Book Net Assets Jan. 1-a 1954	% Return on Net Assets-a 1953	% Return on Net Assets-a 1954	% Margin on Sales-b 1953	% Margin on Sales-b 1954
22	Baking	$ 54,612	$ 54,089	— 1	$ 455,740	$ 476,620	12.0	11.3	3.5	3.3
14	Dairy products	72,954	84,742	+16	650,516	700,051	11.2	12.1	2.2	2.5
15	Meat packing	56,054	28,797	—49	834,931	877,689	6.7	3.3	0.7	0.4
22	Sugar	21,456	26,187	+22	536,782	532,939	4.0	4.9	2.8	2.9
86	Other food products	261,615	279,271	+ 7	2,365,143	2,481,737	11.1	11.3	3.3	3.7
19	Soft drinks	42,271	43,729	+ 3	334,407	349,678	12.6	12.5	7.8	5.2
20	Brewing	32,193	26,796	—17	298,393	311,973	10.8	8.6	3.3	3.6
12	Distilling	79,922	71,276	—11	1,098,081	1,137,634	7.3	6.3	3.3	3.1
20	Tobacco products	130,140	139,660	+ 7	1,303,716	1,364,129	10.0	10.2	3.9	4.4
35	Cotton goods	58,025	31,135	—46	836,642	862,226	6.9	3.6	3.6	2.3
10	Silk and rayon	39,224	29,394	—25	616,597	625,060	6.4	4.7	5.4	5.2
6	Woolen goods	2,378	*D-4,941*	—	98,337	97,698	2.4	*—5.1*	1.2	*—4.4*
16	Hosiery, knitted goods	9,017	5,373	—40	125,898	129,053	7.2	4.2	3.4	2.1
9	Carpets, floor coverings	20,929	17,953	—14	276,749	285,232	7.6	6.3	4.1	3.6
36	Other textile products	60,662	42,469	—30	907,388	933,608	6.7	4.5	3.0	2.3
31	Clothing and apparel	16,924	13,063	—23	249,061	255,238	6.8	5.1	2.7	2.3
28	Shoes, leather, etc.	33,995	34,765	+ 2	333,833	344,459	10.2	10.1	3.2	3.2
27	Tires, rubber products	187,279	171,552	— 8	1,336,966	1,430,249	14.0	12.0	4.2	4.2
28	Lumber	82,378	80,489	— 2	798,846	833,202	10.3	9.7	7.0	6.9
16	Furniture, wood products	17,432	18,890	+ 8	178,514	187,834	9.8	10.1	3.8	4.5
78	Paper and allied products	308,004	335,850	+ 9	2,525,860	2,759,183	12.2	12.2	7.1	7.6
35	Printing and publishing	37,048	39,395	+ 6	351,188	361,814	10.5	10.9	3.1	3.6
65	Chemical products	645,584	752,688	+17	4,882,660	5,191,019	13.2	14.5	7.6	8.9
20	Drugs and medicines	89,479	105,773	+18	649,021	671,379	13.8	15.8	8.1	9.2
20	Soap, cosmetics, etc.	73,442	89,604	+22	580,095	613,997	12.7	14.6	4.8	5.0
22	Paint and varnish	63,723	73,326	+15	500,829	562,608	12.7	13.0	4.9	5.8
94	Petroleum prod. and refining	2,423,985	2,456,233	+ 1	16,488,391	17,731,128	14.7	13.9	10.6	10.7
32	Cement	65,701	88,710	+35	438,150	472,806	15.0	18.8	12.3	15.3
14	Glass products	105,981	123,198	+16	709,207	755,270	14.9	16.3	6.8	7.9
49	Other stone, clay products	122,483	144,018	+18	1,033,634	1,106,557	11.8	13.0	7.1	8.1
58	Iron and steel	786,044	635,173	—14	6,328,040	6,767,677	11.6	9.4	5.7	6.0
12	Agricultural implements	127,005	113,114	—11	1,571,106	1,635,026	8.1	6.9	4.2	4.4
77	Building, heat., plumb. equip.	112,453	118,314	+ 1	1,101,598	1,170,060	10.2	9.7	4.0	4.2
78	Electrical equip., radio & tv.	457,734	516,583	+18	3,067,931	3,351,070	14.9	15.4	4.3	5.0
44	Hardware and tools	37,679	33,231	—12	388,485	406,665	9.7	8.2	4.5	4.8
39	Household appliances	56,020	52,895	— 6	522,870	549,129	10.7	9.6	3.6	3.7
165	Machinery	264,592	253,469	— 4	2,057,549	2,193,168	12.9	11.6	4.8	5.5
23	Office equipment	93,998	114,182	+21	710,950	757,014	13.2	15.1	5.5	6.6
39	Nonferrous metals	324,038	321,327	— 1	2,950,931	3,105,243	11.0	10.3	6.9	7.3
41	Instruments, photo. goods, etc.	105,718	142,734	+35	784,205	842,194	13.5	16.9	5.3	7.2
101	Other metal products	190,442	192,305	+ 1	1,652,716	1,748,614	11.5	11.0	4.0	4.2
14	Autos and trucks	696,012	812,515	+17	3,579,968	3,851,569	19.4	21.1	4.4	6.4
64	Automobile parts	164,208	138,742	—16	1,246,217	1,337,706	13.2	10.4	3.8	4.2
23	Railway equipment	79,397	65,450	—18	865,438	891,724	9.2	7.3	3.3	4.1
38	Aircraft and parts	176,273	271,983	+54	875,191	990,883	20.1	27.4	2.4	3.8
66	Misc. manufacturing	87,000	99,845	+15	739,028	785,326	11.8	12.7	4.8	4.3
1,778	Total manufacturing	8,923,503	9,280,346	+ 4	70,237,793	74,825,138	12.7	12.4	5.3	5.9
27	Coal mining-c	29,030	14,490	—50	819,178	815,834	3.5	1.8	2.4	1.4
30	Metal mining-c	64,409	70,769	+10	728,520	731,798	8.8	9.7	8.6	9.3
11	Other mining, quarrying-c	43,436	52,482	+21	178,079	196,422	24.4	26.7	22.2	24.0
68	Total mining, quarrying	136,875	137,741	+ 1	1,725,777	1,744,054	7.9	7.9	6.3	7.2
25	Chain stores — food	71,993	84,692	+18	564,866	607,261	12.7	13.9	1.1	1.2
52	Chain stores — variety, etc.	121,800	112,059	— 8	1,313,167	1,341,369	9.3	8.4	3.3	3.0
50	Department and specialty	143,530	147,256	+ 3	1,543,597	1,588,973	9.3	9.3	2.5	2.6
6	Mail order	163,054	177,182	+ 9	1,486,429	1,559,274	11.0	11.4	3.8	4.3
53	Wholesale and miscellaneous	68,866	75,729	+10	831,709	863,199	8.3	8.8	1.8	2.1
186	Total trade	569,243	596,918	+ 5	5,739,768	5,960,076	9.9	10.0	2.4	2.5
129	Class 1 railroads-d	902,031	673,597	—25	15,376,024	16,236,952	5.9	4.1	8.2	7.2
29	Traction and bus	18,108	18,734	+ 3	448,270	426,504	4.0	4.4	3.7	3.0
10	Shipping	27,245	18,381	—33	368,811	382,208	7.4	4.8	6.6	5.2
16	Air transport	52,207	56,880	+ 9	358,318	395,556	14.6	14.4	5.2	5.1
42	Misc. transportation	26,262	28,602	+ 9	260,833	269,150	10.1	10.6	6.6	6.1
226	Total transportation	1,025,848	796,194	—22	16,812,256	17,710,370	6.1	4.5	7.6	6.7
252	Electric power, gas, etc.-d	1,192,526	1,321,319	+11	12,590,070	13,885,660	9.5	9.5	13.4	13.6
65	Telephone and telegraph-d	571,346	641,249	+12	6,605,934	7,292,199	8.6	8.8	11.0	10.9
317	Total public utilities	1,763,872	1,962,568	+11	19,196,004	21,177,859	9.2	9.3	12.5	12.6
21	Amusements	39,057	49,669	+27	567,766	578,050	6.9	8.6	3.9	4.3
33	Restaurant and hotel	13,309	12,373	— 7	135,434	147,906	9.8	8.4	4.4	3.5
44	Other business services	72,112	94,189	+31	558,585	598,063	12.9	15.7	6.2	6.9
18	Construction	26,237	22,869	—13	172,257	192,885	15.2	11.9	2.7	2.7
116	Total amusements, services, etc.	150,715	179,100	+19	1,434,042	1,516,904	10.5	11.8	4.3	4.7
346	Commercial banks	665,002	712,324	+ 7	7,156,116	7,520,910	9.3	9.5	—	—
67	Fire and casualty insurance	167,205	178,825	+ 7	2,437,206	2,555,393	6.9	7.0	—	—
186	Investment trusts-e	299,779	353,380	+18	5,425,927	5,705,589	5.5	6.2	—	—
73	Sales finance	173,339	190,427	+10	1,057,179	1,170,582	16.4	16.3	—	—
79	Real estate	17,122	27,003	+58	183,543	192,195	9.3	14.0	—	—
751	Total finance	1,322,447	1,461,959	+11	16,259,971	17,144,669	8.1	8.5	—	—
3,442	Grand total	$13,892,503	$14,414,826	+ 4	$131,405,611	$140,079,070	10.6	10.3	5.6	6.1

a—Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures in most cases exclude capital gains or losses on investments. † Increases or decreases of over 100% not computed. D—Deficit.

turn of 12.4 per cent, or slightly lower than the 12.7 per cent realized in 1953. On total sales and other receipts such net income gave an average net profit margin of 5.9 per cent, or slightly wider than the 5.3 per cent margin in 1953. The longer-term trends of these two averages are shown in the accompanying chart based upon our annual tabulations of leading companies made over a period of years and summarized in the April issues of this Letter.



Average Annual Net Profit Margins on Sales and Rates of Return on Net Assets of Leading Manufacturing Corporations

Over the 30-year period 1925-54, the rate of return on net assets of leading manufacturing companies averaged 10.1 per cent. Last year's return of 12.4 per cent is above that long-term average, including the depression years of the early 1930s. It was, however, well below the level of early postwar years, when the rates of return were swelled by such factors as the abnormal demands for goods, inventory profits on rising commodity markets and depreciation charges inadequate to meet replacement costs, as well as by being computed on book net assets that understated current values.

Last year's net profit margin of 5.9 per cent on sales compares with an average of 5.6 per cent over the 22-year period 1933-54 for which we have compiled such margins.

Congressional Salaries and $20 Bill

February 25 was a banner day in the life of the seven-weeks-old 84th Congress. In a mood of generosity, the House of Representatives passed one measure raising Congressional salaries by 50 per cent and another giving the individual taxpayer a rebate of $20 a year for himself and each one of his dependents. The salary adjustment was approved by the Senate and President and went into effect March 1. It raised the pay of about 350 members of the Federal judiciary in addition to the 531 members of the Congress and will cost $6 million a year. The "$20 bill" was designed to go into effect in 1956. Spread in driblets among 77,000,000 payers of income tax, even this modest sum was figured to involve $2.3 billion a year of revenue loss.

These measures were not conceived as ways of disposing of an uncomfortable surplus of revenue. Despite deep cuts by the Eisenhower Administration in previously scheduled outlays, the Federal Government is in debt to the tune of $277 billion and is adding to this debt at the rate of around $3 billion a year. Opponents pointed out that the benefits would have to be met out of borrowed money and advised Congress to wait for pay raises and tax relief until the budget is balanced. Others suggested that the people back home might consider the $7,500 Congressional pay boost, from $15,000 to $22,500 a year "just a little bit large when compared with the raises they have been receiving."

Despite objections, the pay raise was passed by large majorities in both Houses of Congress.

John W. McCormack of Massachusetts, Democratic leader of the House, stated that he for one would be willing to vote for a raise to $27,500. He stressed the long hours of work and heavy responsibilities, the high cost of campaigning for office, and the increase in the cost of living since 1946 when Congressional pay was advanced from $10,000 to $15,000. Congressman McMillan of South Carolina calculated that, with the 53-cent dollar, and a six-times multiplication of federal income tax, even a $10,000 raise in pay would give the Congressman little more take-home buying power than he had in 1939. President Eisenhower in approving the bill said Congressmen were "badly underpaid" and cited the difficulties of getting good men to seek and take responsible positions in Government. Half of the raise, he pointed out, would go back to the Government in income taxes.

The Congressional pay boost was concurred in by successful men in all walks of life who could understand — from personal experience — the way the combination of price inflation and confiscatory taxation has decimated the real value of a fancy-sounding income.

The arguments favoring a boost in Congressional pay apply with equal force in other occupations. Business and the professions feel the same shortages of men able and eager to take on top responsibilities. The lack is hardly one of native ability. The extremity to which the progressive income tax has been carried is the more likely culprit. This applies in Congress and elsewhere. The income tax puts a curse of social unconscionability on taxable incomes as low as

$16,000 where a 50 per cent tax rate comes into action. Taxes got this way, of course, in the name of depression and war emergencies. Successful people made the disproportionate sacrifices demanded of them. To keep this kind of structure indefinitely is to embrace the socialistic principle that people should be discouraged from expecting material rewards for superior efforts and ability.

Congress repudiated the socialistic principle in raising Congressional salaries. At the same time, with startling inconsistency, tax reduction was pressed to concentrate benefits among those who earn and pay the least.

A Surprise Action

The $20 tax cut proposal emerged as a dramatic surprise, without preliminary hearings or consideration. Designed for the particular benefit of "little folks" and to excuse 5,000,000 or so persons from the income tax rolls, it opened a bitterly partisan debate. Save for some needed repairs on the Revenue Act of 1954, it had been understood that the sole tax legislation in this session of Congress would be to postpone for still another year (from April 1, 1955 to April 1, 1956) previously scheduled cuts in the corporate surtax rate and in excise taxes on liquor, cigarettes, automobiles, and gasoline. The $20 cut was added to a bill to effect these purposes and passed the House by a largely party vote of 210 to 205. Treasury Secretary Humphrey termed the action "irresponsible" and warned of the inflationary perils in a turn to increased deficit spending.

More inflation will bring nearer the day when Congressional pay may have to be advanced again, and perhaps by a larger amount, to compensate for the fact that members will be in the top 1 per cent of the population where more than half of increases in income are confiscated by the Federal Government.

"It has always been as hard as pulling teeth," Congressman Celler of New York stated, "to get the membership to realize that they are entitled to additional compensation." Fortunately, it lies within the power of the Congress, by conducting fiscal affairs more carefully and avoiding more rounds of inflation, to spare itself similar embarrassments in the future.

In the Senate, the $20 bill was revised to moderate revenue loss. The tax cut was left at $20 for single persons but benefits for families were reduced to $20 for man and wife plus $10 per dependent and taken away from people using the split-income privilege to relieve the burden of taxation. For example, no benefit would have been offered to a couple with taxable income in excess of $3,000 and adjusted gross income in excess of $4,667 a year. By way of further amendment, those portions of the Revenue Act of 1954 beneficial to corporations and corporation shareholders would have been struck out. Thus the measure took on the aspect of a bill – perhaps the first of this character in our history – tailored to raise taxes on the rich in order to excuse millions from paying any tax at all.

With indispensable help from Senator Byrd, Chairman of the Senate Finance Committee, the bill in this form was defeated by a vote of 50 to 44. The original House proposal was voted down, 61 to 32. Toward the end of March the Senate and House acted to extend the corporate and excise tax rates for another year as recommended by the President.

Many people were inclined to dismiss the proposal as mere political horseplay. But similar proposals may emerge again. If the Administration achieves its fiscal aims tax reduction will become possible a year hence. Then the issue will be where the cuts should be made. Principles of tax revision warrant review.

Prior to the proposal of the $20 tax cut, the policy recommended by the President had been accepted by leaders of both parties in Congress: namely, that the expenditure level demanded, and the prospering state of the economy permitted, the maintenance of existing tax rates for another year. For 1956 the President held out a hope. In his State of the Union Message he stated:

> Last year we had a large tax cut and, for the first time in 75 years, a basic revision of tax laws. It is now clear that defense and other essential Government costs must remain at a level precluding further tax reductions this year. Although excise and corporation income taxes must, therefore, be continued at their present rates, further tax cuts will be possible when justified by lower expenditures and by revenue increases arising from the nation's economic growth. I am hopeful that such reductions can be made next year.

Until this proposal arose, the only support for immediate tax cuts had come from trade union leaders and the minority of economists who see depression ahead unless we keep pumping out more and more money into the hands of consumers. In the House debate these arguments reappeared. In the Senate the approach seemed to be that the stimulation of consumer expenditures should be financed, not by inflation, but by reduced outlays for modernized plant and machinery and a slowing of industrial progress.

Principles of Tax Revision

That taxes – and income taxes in particular – are too high – is universally agreed. What is the sensible approach to the problem?

First of all, it must be recognized that the Federal Government, with its myriad of agencies and "give away" programs superimposed on a huge defense machinery, is a very expensive establishment. To get taxes down very far will require an easing of international tensions. To get them down much at all will demand zealous attention to excesses in every spending program and to superfluous activities such as the new Hoover Commission has been studying. Here the interests of 77,000,000 personal income tax payers collide with special groups pressing this, that, and the other spending program on the Congress.

Secondly, it is widely agreed that broad tax reductions should be timed so far as possible for periods when the economy may stand in need of stimulation. This was the policy pursued by the Eisenhower Administration in asking a six months' postponement of the excess profits tax expiration in 1953, in allowing tax cuts for individuals to come into play in 1954, and in pushing through the Revenue Act of 1954. Although this apparently delayed the rebalancing of the budget, it is widely agreed that tax relief played an important, and possibly crucial, part in stemming the 1954 recession and improving the business and revenue outlook for 1955.

Thirdly, the scheduled drop in the 52 per cent corporate income tax rate, postponed by the Revenue Act of 1954 and now once again, should be allowed to go into effect next year without more delays. It is hardly sound political or economic policy for the Government to demand a bigger stake in corporate profits than the shareholders. The change, under competitive market conditions, should benefit consumers by lower prices as well as firm up internally-generated flows of funds for an expanding economy. Foreign governments are progressively easing taxes on incorporated enterprise. If we do not follow we may achieve the dubious distinction of taxing corporations more heavily than any other nation in the world.

The Personal Income Tax

Questions of personal income tax divide between coverage and rate. We now have 77,000,000 personal income tax payers in a population of 164,000,000. A majority of persons of voting age still pay income taxes, though there are uncounted millions of adults who exempt themselves in various ways. The $20 bill would have exempted five million more persons from paying any income tax at all. As was brought out in the debates, responsible government demands a broad base of tax-conscious citizens. If the person who pays only a few dollars of income tax is conscious of a burden, that is one more person interested in the prudent conduct of Government. From the difficulties of controlling government expenditures it is apparent that his interest is needed.

The idea of per capita reductions in tax is a curious innovation. Senator Carlson of Kansas, at the Senate hearings, wondered if "we were starting out on a new philosophy" that would call for increasing income taxes on a per capita basis if additional revenues were needed. It seems more sensible, as Senator Carlson commented, to provide tax relief in the same proportions that taxes were advanced. This was the formula of the personal income tax reductions effective January 1, 1954, which simply cancelled the increases imposed by the Revenue Act of 1951. Following this approach, the logical next step would be to cancel the increases imposed by the Revenue Act of 1950.

A third question is that of the personal exemption, raised from $500 to $600 by the Revenue Act of 1948. This strips more than $80 billion out of the income tax base and, along with more and more additions to the list of lawful deductions, helps account for the toughness of the rates. The real problem of the income tax lies in the rates, which are too high straight across the board. The initial rate of 20 per cent is the most expensive to cut in terms of revenues; the highest rates, running up to 91 per cent, are socialist symbols which warn people to keep their taxable incomes under control and thus defeat the purpose of collecting revenues.

A final, related question is whether Government is not placing an undue strain on income tax: whether a low-rate general sales or excise tax should not supply some of the revenue needs. Certainly we could use a better rounded tax system, one that fortifies the will to productive work, exacts some levy from the free-spending income tax evader, and relieves the preoccupying concern of honest people with tax problems.

By the testimony of Sidney Margolius, writing in *Harper's Magazine,* the strategy of tax avoidance "has become a new national pastime, second only to baseball in general interest and to none in excitement, because more people can play and all of them play for keeps."

Class Legislation

Senator Douglas, among others, has expressed the point of view that special relief for small taxpayers is needed to redress the alleged iniquity of the $7.4 billion tax cuts in 1954. He called the Revenue Act of 1954 a "plutogogic"

tax bill, and singled out the partial relief from double taxation of dividends provided in that Act as "class legislation at its worst." This measure, when fully effective, is calculated to involve a revenue loss of $350 million a year—something less than one-twentieth of the total tax relief given in 1954. It still left the Government asking as much as 93.7 per cent of corporate incomes paid out in dividends and the shareholder getting as little as 6.3 cents on the dollar of distributed profits. If the 6.3 cents received by the shareholder represents unconscionable greed, what name can be found for the 93.7 cents appropriated by Government?

Senator Douglas calculated that "over $5.7 billion—77 per cent— of last year's tax cuts went to corporations and individuals with incomes over $5,000. Only $1.7 billion—23 per cent—went to those on incomes less than $5,000." These figures are not very helpful without reference to tax burdens carried. Before the 1954 reductions, individuals with incomes under $5,000 are estimated to have been paying only 18 per cent of the total of all Federal income taxes levied; thus, in receiving 23 per cent of the reductions, it would seem that lower income groups were disproportionately favored.

Income tax reductions, forsooth, do not provide a useful avenue for helping people who work so infrequently in taxable employments that they pay little or nothing. Such people may be divided into three main classes: retired persons living off their own savings; the children, the aged and infirm who are dependents of others; and those who live in substantial part on tax-free income provided by government pension, relief and unemployment payments. The first group can be helped best by protecting the nation from the scourge of inflation; the second group by easing the burdens of taxation on workers; and the third group by increasing government pensions (as was done last year) and raising relief and unemployment pay.

Relief and unemployment programs constitute the most direct way of helping people with negligible taxable incomes. There is also the seamy side. These programs dip into earned incomes to provide tax exempt incomes for people who are idle. Thus, as an inevitable by-product, they invite an expansion of the class of professional ne'er-do-wells.

A newspaper column by Frank Tripp recently attacked shirkers living off honest men's wages and taxes. The unsigned replies he received give some clue as to why taxes and inflation constitute the problems that they do:

> We elected the lawmakers who gave us easy going, and we'll keep 'em elected. We are entitled to all we can get and your yelping can't stop it. . . .
>
> The newspapers talk as if they are paying the bill. What business is it of theirs if the government pays the shot? The government only has to print the money.

A Boom That Defies Predictions

With the coming of spring, the homebuilding industry, after a record-breaking winter, is heading into what is normally its biggest season with all flags flying.

Everywhere over the country new homes are mushrooming at a rate that continues to defy predictions. New nonfarm housing started in January and February was greater than in the corresponding period of any previous year. Contract awards for future homebuilding January 1 through March 22 (compiled by F. W. Dodge) were over 40 per cent ahead of a year ago. Federal Housing Administration and Veterans Administration offices are deluged with applications for mortgage insurance and requests for appraisals. With nearly 10 million new homes built since the war, with many sold on a shoestring—"nothing down and thirty years to pay" —and with home mortgage debt at a peak of $75.6 billion, it is small wonder that people shake their heads and wonder whether the homebuilding boom is heading for a bust.

In 1954, the homebuilding industry proved to be one of the major props cushioning the business recession, turning out 1,221,000 new dwelling units—second only to the 1950 record. For 1955, the consensus seems to be that 1.3 million or more units will be started.

Many responsible observers are troubled by the current rate of building and the easy terms of financing. In a statement issued last month, the Joint Committee on Economic Policy of the Life Insurance Association of America and the American Life Convention, composed of life insurance company presidents and representing institutions which have been heavy lenders on home mortgages, expressed concern that "at the current very high rate the residential construction industry is drawing on future demand." The committee recommended that measures "be taken promptly by Government and private groups to dampen down the boom in housing," due basically, it was charged, to "excessively easy credit."

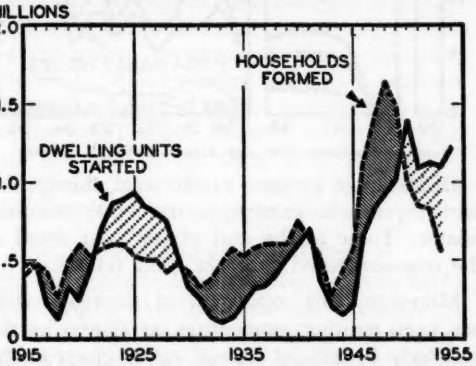
Voicing similar misgivings, Homer J. Livingston, president of the American Bankers Association, in an address last month, warned: "No one is competent to say that the spread at present between the formation of households at the rate of 600,000 a year and new private housing starts

at the [January '55] rate of 1,424,000 a year is a safe and sound margin. But it does not seem reasonable that we can forever continue building housing units annually at a rate of 800,000 in excess of the number of households formed."

The questions raised are thus two-fold: (1) are we putting up too many new homes and so preparing the way for a future slump; and (2) are people getting too far out on a limb in the amount of mortgage debt they are incurring?

Homebuilding and Household Formation

Turning first to the question of overbuilding, it is natural to look initially to household formation. The accompanying chart compares the number of nonfarm dwelling units started each year with the net annual increase in households.



Nonfarm Housing Starts and Households Formed Annually

Figures on households are estimates by the Census Bureau based on annual samplings. The Bureau defines a "household" as including all of the persons who occupy a house, an apartment or other group of rooms, or a room, that constitutes a dwelling unit. Changes in the number of households are effected largely by marriages, divorces, deaths, and doubling or undoubling of individual family units. Though the Census figures are the best available on the subject, even these are none too reliable, being based on samplings rather than upon full counts.

First to be noted in the chart is that the number of new homes started has exceeded net household formation in every year since 1950 inclusive. Hence the constant expectation that homebuilding was bound to decline.

A major reason why it has not declined stands out clearly. As shown by the heavily shaded area, between 1930 and 1949 – a period of 20 years embracing both the depression and World War II – there was only one year (1941) when homebuilding even came up to household formation, and most of the time it lagged substantially behind. Not until 1950 did housing starts catch up with household formation. Part at least of the high building since can be ascribed to making up the previous deficit.

The impetus given to home building by abnormal "catching-up" factors is now generally agreed to be pretty well dissipated. While the decline below 600,000 in household formation recorded in the April '54 estimate may be an aberration due to imperfect sampling or to the influence of the temporary business dip, nevertheless it is clear that we are in the trough of the cycle of marriages and family formation stemming back to the low birth rate of the '30s. About the best that can be looked for is that the decline in marriages and family formation will level off until such time as the big baby crop after the outbreak of World War II begins to be reflected in an increase of people reaching marriageable age in the early 1960s.

A Game of "Musical Chairs"

New factors in housing demand, however, have exerted a strong sustaining influence on homebuilding and may continue to be potent.

What has been happening was aptly described in the report of a recent round table discussion sponsored by the *House & Home* magazine and including 17 of the 21 members of the President's Advisory Committee on Housing Policy. The report concluded:

> By building 500,000 more good new homes this year than America needs to keep pace with population growth, we are enabling millions of families to play musical chairs and each move to a better home. The continuation of this upgrading will ultimately make it possible for many, many thousands of families to move out of the slums and make it possible to demolish many thousands of substandard units.

This national game of "musical chairs" is the result of many factors, including the high birth rate and income levels, and the easy availability of mortgage credit.

The appearance of the second, third, or forth child in an increasingly large number of families has made small homes and apartments inadequate. Also, the rising level of real income and living standards has encouraged undoubling of family units and made people dissatisfied with their present living quarters – in many cases old-fashioned and ill-suited to modern conditions. Probably never before has the building industry made such great strides in offering a package of attractive design and convenient layout. This is playing a big part in stimulating demand.

There is the mass trek to the suburbs, and great shifts of population in the opening up of new industrial regions and in the development

of new highways. The drop of some 600,000 farm households in the four years 1951-1954 suggests another source of urban housing demand.

Housing Replacement Speeded Up

The question arises, what is happening to the dwellings people are moving out of?

Apparently the answer lies both in some increase in vacancies and in stepped-up withdrawals of dwellings from the housing market. Ordinarily, demolitions caused by fires, floods, and other factors are estimated at 40,000 to 70,000 a year. Today an additional large number of homes is being taken away by demolition for highway and slum clearance projects, razing of postwar emergency housing, conversion to commercial and other uses, and outright abandonment in the case of substandard structures.

When all is said and done probably the best test of whether we are overbuilding is in the number of dwelling units standing vacant. Here, unfortunately, reliable and comprehensive data are lacking. Information at hand suggests that vacancies have been rising in some areas but in general have not reached serious proportions. The continued slow rise in residential rents and the sustained resale market for older homes confirm the impression that vacancies have not yet increased to the point where they are affecting the real estate market generally.

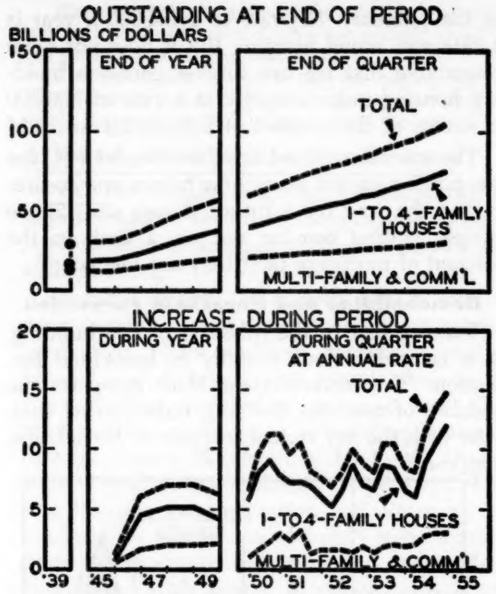
An obvious but important point in this connection is that housing cannot move to where the market is. A vacancy in a New England town or an abandoned farm in the South does no good to a house-hunter in California. Nor does a nearby vacancy help if it is not the type the home-seeker wants.

Thus, despite the headlong pace of building, evidence of reaching the saturation point is not conclusive. The key is the replacement market, potentially vast but closely dependent upon high incomes and easy credit. It is a market based on the desire for better things rather than – as in the early postwar period – on the pressing need for almost any kind of shelter. As such, it is more vulnerable to a change in general prosperity or to a tightening of credit.

The Mortgage Debt Question

The other principal worry about the housing boom is the growth of mortgage debt.

As shown by the next chart, total nonfarm mortgage debt at the end of last year reached an aggregate in excess of $100 billion, approximately double the level prior to Korea, and more than treble that at the end of World War II.



Nonfarm Mortgage Debt and Annual Rates of Increase

Of the huge increase in the total, the greater part represents mortgages on 1- to 4-family homes. These at the end of last year stood at the unprecedented figure of $75.6 billion.

Moreover, this expansion of mortgage debt has been gaining momentum, as shown by the quarterly figures (at annual rates) given in the lower panel of the chart. With the cheapening of money and easing of mortgage credit terms, the net increase in the mortgage total soared in the fourth quarter of '54 to an annual rate of $15 billion. This contrasts with an actual annual average increase for 1950-54 of $10 billion. For 1- to 4-family houses alone the net annual rate of increase for '54 reached $12 billion, against a 1950-54 average increase of $8 billion.

Formidable as these figures are, they should nevertheless be measured against underlying incomes and assets, which also have grown. Total home mortgage debt was equivalent to 29.8 per cent of disposable personal income at the end of 1954 – an increase from 23.2 per cent in 1939, reflecting in part the marked growth in home ownership. Lower interest rates and longer maturities, however, have made servicing the mortgages easier. As pointed out by George C. Johnson, president of the Dime Savings Bank of Brooklyn, "Regular payments on mortgage principal and interest now amount to about 2.6 per cent of all spendable income, compared with 2.7 per cent in 1939 – a year in which mortgage debt was not considered excessive."

In early 1954, a Federal Reserve survey found that three-quarters of home owners with mortgages spent less than 20 per cent of their income on mortgage interest, amortization, and property taxes; only 8 per cent spent more than 30 per cent of their income for these purposes.

Despite low down payments, home owners have been building up an equity in their property through amortization and improvements, as well as through the gradual inflation of real estate prices. Even in the case of homes purchased on little or no down payments, experience shows the owners in most cases making improvements which add to the margin of equity. Despite the long terms of mortgages written, figures for insurance companies as a group show the average maturity of their nonfarm mortgage portfolios at about eleven years, reflecting regular amortization, prepayments, and refinancing incidental to property sales. In only 4 per cent of the owner-occupied homes surveyed in early 1954 for the Federal Reserve Board was the equity less than 20 per cent; in 37 per cent of the homes it was 40 per cent or more, while 49 per cent were entirely debt free.

Where the Danger Lies

The foregoing facts and figures seem to imply that, judged by past standards and relationships, the present level of home mortgage debt is not so disturbing as the current rate of expansion and the new pattern emerging. Whereas in 1953 only 8 per cent of the mortgages guaranteed by the VA were made without down payment, by the latter part of '54 this proportion had risen to over one-third; in 1953 only 40 per cent of the VA mortgages had maturities of 25 to 30 years, against 70 per cent in late '54.

All told, of the $75.6 billion of mortgage debt outstanding on 1- to 4-family properties at the end of 1954, 42 per cent was insured by the FHA or guaranteed by the VA. In the final quarter of '54 alone, the proportion of dwelling units started with government-underwritten mortgages had risen to 56 per cent.

This rapid expansion in government-backed loans, and the housing boom it has fostered, stress the need for serious thought as to the consequences of government guarantees and insurance that have tended to weaken traditional incentives for caution among builders, lenders, and buyers alike. The statement by the committee of life insurance company presidents referred to before minced no words on this point:

> This is certainly no time for 30-year, no down-payment mortgage loans guaranteed by the Veterans Administration. Such terms are an open invitation to a boom-bust situation in home-building, and they actually penalize the veteran by contributing to a higher price for his house.
>
> We urge that Congress act promptly to require some down-payment and a shorter maximum amortization period on VA mortgage loans. Moreover, down-payment and amortization terms on FHA insured loans should also be tightened promptly.

An equally frank diagnosis of where the program has gone wrong and a clear statement of the principles that should govern, appear in the following from the report of the *House & Home* conference of experts cited earlier:

> The less help our industry has to accept from government, the better for our industry. For 20 years now we have been forging a closer and closer partnership with government through the Home Loan Bank Board, the Federal Savings and Loan Insurance Corporation, and especially through FHA and VA. That partnership has enabled millions of families to buy better homes for less money. . . .
>
> We have allowed builder, lender, and buyer — all three — to profit from the partnership without putting up as much of the money or carrying as much of the risk as they could and should.
>
> We are now unanimous in declaring this was and is a mistake. . . . We are unanimous in urging that everyone accept the principle of the shared risk.
>
> No builder should be able to get government help on his financing unless he stands to lose some of his own money first if his judgment on the house proves wrong. No buyer should be able to get government help on his financing unless he stands to lose some of his own money first if the house proves a bad investment. No lender should be able to get insurance on his loan unless he stands to lose some of his own money first if his judgment proves wrong and the loan is defaulted.

All this is only common sense and in accord with good lending practice. Indications over the past month are that money market forces are beginning to come into play that may in themselves exert a tempering influence on mortgage lending terms and conditions. Although the 1½ per cent Federal Reserve discount rate remains undisturbed, the banking authorities in recent weeks have allowed unseasonably strong credit demands to take up slack in the money market with the result that lenders are perceptibly more choosey about the mortgages they will take. The Treasury sale of $1.9 billion forty-year 3 per cent bonds two months ago similarly subtracted something from the potential supply of mortgage funds. These cautioning influences can be carried further as need be so as to relieve tendencies for excesses of credit supply to create a glut of over-priced new houses. In the long run it will be better for everyone if homebuilding can be stretched out and maintained at levels within the capacity of the market to absorb, than if it goes rushing ahead in a boom that overloads the market and home owner and winds up in a bust.

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